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On the way to Cannes - the BIC's evolving agenda in the G20

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Good bye currency wars, hello inflation fears

The G20 road to Cannes is likely to be littered with dissent and unfulfilled pledges. Before the next summit takes place in early November, there is little hope to narrow the divergences within the group over key issues, most notably persistently large global imbalances, volatile capital flows, ultra-loose monetary policy in the US, and currency manipulation by China.

The G20's poor record on several commitments will call into question its effectiveness and fuel criticism of the group.[1] While most G20 countries have embarked on fiscal consolidation, their Toronto pledge to halve budget deficits as a percentage of GDP by 2013 looks hard to reach—especially in the case of the US, with a projected 2011 deficit of almost 11 percent of GDP and a dysfunctional political process. Moreover, the problem of global imbalances remains as pressing as it was when the G20 pledged to promote balanced growth at the Pittsburgh summit. And while China has delivered some Yuan appreciation

G-20 Summits

Washington (November 2008)
London (April 2009)
Pittsburgh (September 2009)
Toronto (June 2010)
Seoul (November 2010)
Cannes (November 2011)

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[1] According to the G20 Research Group at the University of Toronto, only 62-64% of the commitments made in the London, Pittsburgh, and Toronto summits were met.

since the currency peg was lifted in mid-2010, it was only modest and largely motivated by domestic concerns about inflation.

Indeed, while successive G20 meetings continue to expose the rifts among member countries and their poor track record, inflation has re-emerged as a global policy issue. Inflation fears have grown markedly on the heels of surging food and fuel prices. Although higher commodities prices pose a challenge for all countries, in the emerging world they are compounding domestic liquidity-driven inflationary pressure, shifting the debate from 'currency wars' to inflation fears.

Background: the Seoul Summit (November 11-12, 2010)

The Seoul summit met everyone's low expectations, producing no tangible results. On the hot topics in the G20 agenda—the currency wars and the underlying global imbalances—G20 leaders simply agreed to disagree. A few positive achievements were scored regarding IMF reform and financial regulatory overhaul, while the two new items introduced by the host country (global financial safety nets and development) did not advance beyond expressions of general support.

In the run-up to Seoul, there was a clear shift in the public debate, from generalized criticism of the Chinese exchange rate policy to widespread condemnation of US monetary policy. Germany, China, and Brazil were particularly vocal about the Federal Reserve's decision to purchase an extra $600 million of government bonds, expected to lead to a surge of capital flows into emerging countries, strengthening their currencies, creating asset-price bubbles, and complicating monetary policy. The FED insisted that its quantitative easing policy (the so-called QE2) was not aimed at weakening the dollar, but at stimulating US economic activity, which was the best way to promote the still anemic global recovery. While emerging markets bounced back strongly from the 2008/09 financial crisis, the recovery has been more sluggish in the US and in Western Europe, saddled with bloated sovereign debts and high unemployment.

The lack of a big breakthrough in Seoul illustrated the difficulties involved in international coordination outside the emergency room. The dual-speed recovery following the global financial crisis encouraged uncoordinated actions by G20 countries, rooted in their different (and often divergent) assessments of the nature of global problems and their focus on the domestic agenda.

The key topics at the Seoul Summit

Recovery and global imbalances

G20 leaders acknowledged the downside risks of uncoordinated actions, but reached at best a modest agreement on global imbalances during the summit. In the Seoul Action Plan, they pledged to bring current account balances to "sustainable levels", but postponed the hard decisions on how to identify and correct global imbalances to the next summit. At the same time, G20 leaders promised to move toward "more market-determined" exchange rate systems, and to avoid competitive devaluations.

With the US on the defensive, its proposal for the adoption of numerical targets for current account balances was dropped. This was replaced by a commitment to develop *indicative guidelines* to track trade imbalances that "require preventive and corrective actions", without, however, any reference to enforcement mechanisms. The guidelines would include a range of indicators, to be agreed by G20 financial leaders in the first half of 2011. This early warning system would be part of an enhanced Mutual Assessment Process (MAP) spearheaded by the IMF. Given past failures in securing agreement on a framework to curb global imbalances (including the 2006 IMF multilateral consultations), the Seoul Action Plan was not expected to fare much better.

IMF reform

G20 leaders ratified the IMF governance reforms expanding the representation of emerging market countries agreed in October 2010 at Gyeongju (South Korea) and subsequently endorsed by the IMF Executive Board. While this is clearly a step forward, the details still need to be worked out before the changes become effective in 2012, including the expected horse-trading over country representation in the Board. By enhancing the IMF's legitimacy and credibility, the reform could facilitate the process of international economic coordination, as large emerging countries gain increased influence (and faith) in the institution.

Financial regulatory reform

G20 leaders endorsed the stricter regulations under Basel III, calling for higher amounts of bank capital and liquidity. The new rules will be phased in gradually from January 2013, becoming fully effective by 2019. While critics claim that Basel III has been too diluted to prevent another major financial crisis, supporters point to the successful completion of the task initiated during the Washington summit in 2008, when financial reform was a clear priority for the G20. With the crisis behind them, however, concerns about the adverse impact of stricter regulation on growth have come to dominate the agenda.

Moreover, unresolved disagreements over the regulation of systemically important financial institutions (SIFIs) and divergences on the implementation of the new rules across countries could undermine the effectiveness of the new framework. In view of the deep divisions regarding stricter requirements for institutions deemed 'too big to fail', the Seoul summit produced only a commitment to establish new guidelines for SIFIs.

Global financial safety net

South Korea made some headway on its proposal to create a safety net for countries facing temporary liquidity problems. The idea is to replace a conventional post-crisis IMF rescue package with pre-arranged financing tailored to individual countries with a view to cooling down markets. With the memories of the Asian crisis still fresh in the minds of policymakers, South Korea had hoped that the initiative could be operated by central banks. But, in the event, G20 leaders placed the IMF in charge, endorsing the recent expansion of IMF lending facilities for countries facing a sudden liquidity crunch. Details on the new safety net framework would need to be fine-tuned, including how to offset the potential moral hazard involved in the scheme.

Development

South Korea also proposed the launching of a new framework for G20 engagement with the rest of the developing world. The "Seoul Consensus for Shared Growth" was designed to change the focus of international development away from financial aid to the broader factors underpinning economic growth, such as infrastructure. The channeling of savings from surplus countries into urgently needed infrastructure investments in poor countries could help reduce global imbalances. While the G20 agreed to include development permanently in its agenda, the group leaders recommitted to their traditional aid pledges, following warnings from aid agencies and the UN.

Challenges for the French presidency

Under the slogan 'New World, New Ideas', France put forward an ambitious agenda for its rotating presidency of the G20 in 2011. With the upcoming presidential elections in mind, President Sarkozy kicked off the discussions by urging G20 leaders to overcome their differences in order to remain relevant as the premier forum for global economic cooperation. To keep the momentum for coordinated action alive, French representatives highlighted the G20's past achievements, pointing to tangible success in strengthening financial regulation and supervision; establishing a framework for sustainable and balanced growth; and improving global governance with reforms at the IMF and at the World Bank.

The French have their work cut out. The recent preparatory meetings for the Cannes summit have shown little progress in narrowing substantive disagreements within the G20. The first ministerial in Paris last February did not go smoothly: after lengthy discussions, G20 financial leaders settled on a two-step strategy to resolve global imbalances that put off the difficult policy decisions until subsequent meetings. Otherwise, the (reportedly tense) meeting delivered only a timetable for the group's 2011 work program.

By contrast, the April ministerial in Washington DC (during the IMF/World Bank Spring Meetings), was hailed by French representatives as a pragmatic, 'happy G20'. Despite their claim that significant progress had been made on all fronts, however, concrete agreement was reached only on a small step towards rebalancing global demand. The rest of the agenda was 'happily' kicked down the road. And, with world trade talks on the verge of collapsing after nearly ten years of negotiations, there was no reference to the Doha Round in the communiqué.

Key themes in the French agenda

The top priority under the French presidency is the reform of the international monetary system, including strategies to curb global imbalances and to manage capital inflows. France has also placed the issue of volatility in commodity prices high on the G20 agenda, stressing its impact on food security. Given the G20's poor track record to date, France is pushing hard for a more systematic follow-up on ongoing projects, including financial sector reform implementation.

Reforming the International Monetary System

France's ambition to have a blueprint for reform of the international monetary system (IMS) before the Cannes summit has already been tempered by the realities of G20 dynamics. After an initial call for the adoption of a 'new Bretton Woods', in a direct challenge to the dollar dominance in the global financial system, France has toned down the rhetoric, stressing incremental change rather than revolution. To motivate the need for reform, the French Chair started by pointing out the numerous deficiencies in the workings of the current international monetary system, including rising global imbalances, exchange rate volatility, destabilizing capital flows, and excessive accumulation of reserves by some emerging countries.

To address these systemic flaws and secure the international monetary system against future crises, the French presidency proposed G20 action to:

- **Strengthen macroeconomic policy coordination** through effective implementation of the G20 peer review process (the "Framework for Strong, Sustainable and Balanced Growth" adopted in Pittsburgh) with a view to unwinding global imbalances.
- **Support a move towards a multi-polar global currency system** by encouraging the internationalization of the currencies of major emerging countries, and expanding the use of the IMF's Special Drawing Right (SDR) as a global reserve currency.

- **Avoid destabilizing capital flows** by giving the IMF oversight authority to monitor a set of multilateral rules (a "code of conduct") to be agreed by the group.
- **Reduce the need for precautionary reserve accumulation** through enhanced liquidity support from the IMF.

This list includes highly inflammable material, dashing the hopes for quick compromise in the consensus-based G20. But the agenda received a boost from the Palais-Royal Initiative, a group of 18 former ministers, central bank governors, and other preeminent officials. The group's February report acknowledged the main vulnerabilities in the current system as identified in the French agenda, and offered 18 concrete recommendations for a bold overhaul of the international monetary system. The Palais-Royal suggestions, which place new emphasis on the IMF's global monitoring role, include: strengthening IMF surveillance (including the possibility of sanctions for non-compliance with the new norms); empowering the IMF to define globally-consistent exchange-rate norms to address currency misalignments; developing a better analytical approach to measure and monitor global liquidity and to manage capital flows; revamping global governance structure; and exploring the possibility of using the SDR as a global currency.[2] Joseph Stiglitz and other leading economists have gone further, arguing that a substantially enhanced issue of SDRs by the IMF should be the first step in IMS reform.[3]

The debate on IMS reform continued in a more academic setting in early March at the old Chinese capital of Nanjing. The Nanjing seminar reflected France's attempt to engage China in its quest to forge a new global financial architecture. G20 officials discussed ways to reduce reliance on the U.S dollar for trade and as a reserve currency, including by transforming the SDR into a global currency. Governments are still divided on this, not the least because it would require overcoming significant practical, political, and legal hurdles. More generally, while there seems to be agreement on the broad goal of IMS reform, there is no convergence on the means and speed to reform the system. As noted by the historian Harold James, compared to the situation during the post-war Bretton Woods conference, "we have neither the optimism, nor the urgency".

The IMF has emerged from the global financial crisis in a stronger position to take the lead on monitoring systemic risk and supervising G20 macroeconomic policies. It has already boosted its toolkit to deal with future crises with the activation of a $581 billion crisis fund (the New Arrangements to Borrow) in early April—an important step toward becoming an effective global lender of last resort. While there seems to be some support from the G20 for a stronger role for the IMF in a reformed global financial architecture, the Fund has often come under fire from emerging countries for its perceived attempts to advance the agenda of developed countries. And its effectiveness would depend critically on the establishment of meaningful binding rules and enforcement mechanisms for the revamped system—a pipe dream in a group where countries remain so far apart.

Curbing global imbalances

Global recovery is under way, albeit at different speeds among G20 countries. But it is a shaky recovery, threatened by overheating in emerging countries and by high unemployment, debt overhang, and financial fragility in the advanced economies. International coordination is more challenging under this divergent growth scenario. Successive IMF reports have shown little sign of rebalancing in global demand, as emerging countries continue to accumulate large trade surpluses and international reserves, while output gaps widen in advanced economies. And so far there has been no meeting of minds in the G20 on the root causes of the imbalances and on the policies to fix them.

There have been also deep disagreements about how to identify a common yardstick to measure global imbalances. After the US proposal for a common

[2] See: "Reform of the International Monetary System: A Cooperative Approach for the Twenty First Century" (February 2011), prepared by a group convened by Michel Camdessus, Alexandre Lamfalussy and the late Tommaso Padoa-Schioppa.
[3] See Stiglitz' proposal in: "The best alternative to a new global currency", Financial Times (March 31, 2011).

numerical target for current account balances was rejected in Seoul, the French Chair explored the option of establishing guidelines for each G20 member, taking into account country-specific circumstances. In the event, the G20 adopted a gradual, two-step approach to deal with global imbalances, predictably leaving the third step (the action) for later.

The **first step** involved the establishment of a set of indicators to measure global imbalances, as well as a process (or *indicative guidelines*) to determine which countries have economic imbalances that should be subject to peer review.

A set of domestic and external indicators were defined after heated debate at the Paris ministerial meeting, while the guidelines for evaluating these indicators were approved during the April meeting in Washington DC.

Indicators to measure global imbalances

- public debt and fiscal deficits; private debt and private savings rate.
- the external imbalance, reflecting the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary and other policies.

The *indicative guidelines* establish "reference values" for each of the indicators, against which countries will be assessed. They apply for the period 1990-2004, before the buildup of significant imbalances, thus relieving pressure on the countries with the largest distortions. Four different methods will be used to identify which indicators are out of line with historical experience. While all G20 countries will be evaluated on the basis of these guidelines, systemic countries (those counting for more than 5 percent of G20 output) will be put through the IMF's fine comb, given their potential spill-over effects. The list of these "too-big-to-ignore" countries was not published, but it is understood to include the seven largest G20 economies (U.S., Japan, Germany, China, France, U.K., and India).

The **second step** will include an IMF assessment of the policies of G20 countries singled out for an in-depth analysis, to be completed before the next ministerial meeting in October. This enhanced MAP or "MAP PLUS" will include an action plan with suggested policy adjustments for the scrutinized countries, to be discussed by G20 leaders before they are presented to the heads of state in Cannes.

While the French Chair has tried to frame the agreement as a major step in advancing a top G20 priority, clearly it does not ensure that the ultimate goal (unwinding global imbalances) will be met. First, the hard-fought list of indicators agreed in Paris excluded important items, such as international reserves and exchange rates (which appear only indirectly, in a reference to countries' exchange rate policy) due to fierce opposition from China and other emerging countries. Secondly, with financial risk constantly changing, the usefulness of backward-looking indicators to predict crises is limited. Finally—and importantly—so far there has been no agreement on a credible enforcing mechanism to guarantee that the recommended policy adjustments are put in place. Reliance on peer pressure (or 'hoping for goodwill' among G20 leaders, as suggested by the French Chair) is hardly a strategy for success.

Managing capital inflows

The relentless flow of speculative capital into emerging countries has led to the adoption of various types of controls to dampen their impact on domestic currencies and relieve pressure on monetary policy. These intervention measures, historically opposed by the IMF (especially if they discriminate between domestic and foreign investors) are now being reassessed in light of recent country experiences in managing capital inflows, as well as increasing support for their use within the G20.

There are wide gaps between the views of advanced and emerging countries on capital flow management. Advanced countries have become more open to the use of prudential, administrative, and tax measures to limit excessive capital inflows under certain circumstances, based on a set of agreed rules and IMF monitoring.

But the establishment of a 'code of conduct' for managing capital inflows—one of the priorities in the French agenda for the G20—has run against stiff opposition from emerging countries.

The debate heated up with the publication of the post-crisis, more pragmatic IMF position on capital controls in early April. To avoid conflict with emerging countries, the IMF proposal was labeled as a 'framework' for policy advice, rather than the more prescriptive term 'guidelines' (nevertheless widely used in the press). The framework consolidates the evolving institutional view, acknowledging that short-term controls are part of the policy toolkit to manage inflows of hot money, but distinguishing them from long-term barriers to foreign capital. Under the new framework, a country could use capital controls as a last-resort, temporary measure, when its currency is not undervalued; when it has enough foreign exchange reserves; and when it is unable to use monetary and fiscal policy instead of the controls. Experience has shown that this has happened quite often—a fact recognized in the Fund's more pragmatic position.

Emerging countries were not impressed. They claimed that adoption of the framework was premature due to the lack of analytical consensus on this issue, and to the omission of a comprehensive analysis of the drivers of global capital flows (another IMF paper on the relative importance of 'push vs. pull' factors is supposedly forthcoming). Importantly, emerging countries opposed any attempts to establish rules that may constrain their policy response to a surge in capital inflows. After a contentious debate, the proposal was endorsed by the IMF Executive Board with less support than usual, as a 'significant minority' of country members objected to the use of the framework in future IMF surveillance. In an attempt to reconcile the conflicting views with the G20, the French representatives emphasized the need to come up with viable options to reduce the negative impact of abrupt capital flows in a pragmatic way, avoiding ideological debates.

The whole discussion may become academic before financial leaders book their tickets to Cannes. The FED has recently signaled the end of its quantitative easing

policy by mid-year, and the ECB has already raised its policy rate. With the expected increase in interest rates in the US and other advanced countries to rein in growing inflationary pressure, hot money flows to emerging countries may well slow down in the coming months. While this may be a relief in terms of managing destabilizing inflows, inflation is becoming a greater concern than export competitiveness, and this may well lead to more currency appreciation in some emerging countries.

Reducing volatility in commodity markets

G20 countries are facing new challenges related to increasingly high and volatile energy and food prices. The recent spike in commodity prices is explained by the interaction of relatively inelastic supply and rising demand. Poor weather, upheaval in the Middle East and North Africa, and increasing demand from fast-growing emerging countries have all contributed to push up commodity prices (with skyrocketing fuel prices putting additional pressure on food prices). Through its impact on inflation and expectations, higher commodity prices could lead to political instability, reduced growth prospects, and lower living standards, unwinding recent gains in poverty reduction. Excessive fluctuation of commodity prices could also affect financial stability, since commodity derivative markets are not subject to a specific regulatory framework.

France has called for G20 action to curb speculation and reduce excessive volatility in commodity markets, so as to alleviate the social impact of high food and fuel prices. The French have tried to drum up support for increased regulation of financial transactions in commodity markets, stronger hedging instruments against excessive price volatility, and enhanced transparency for the physical commodity markets, including the establishment of a common data base for supply and demand trends (the Joint Agricultural Data Initiative, modeled on the G8 Joint Oil Data Initiative).

France's call for tougher regulation and more transparency have not been fully backed by the G20. Once again, it is proving difficult to forge consensus within the diverse group, this time because exporters and importers are on opposite sides or the argument.

Moreover, France faced opposition from some European G20 countries, which argued that regulation of commodity derivatives could end up by simply reducing market liquidity. Against this background, the April communiqué simply noted the need for "appropriate regulation and supervision" in financial activity in commodity futures markets, calling for more transparency in both cash and futures markets.

But again, no concrete agreement was reached. G20 finance ministers asked the International Organization of Securities Commission (IOSCO) to finalize by September a set of recommendations on regulation and supervision of commodities markets to avoid market abuse and manipulation. They also welcomed the preliminary suggestions from various international organizations on ways to address excessive price volatility in commodity markets. But any decisions were postponed until they review the recommendations of G20 agricultural ministers, scheduled to meet next June in Paris.

Financial sector reform

With the more urgent measures adopted after the 2008/09 crisis, financial sector reform slipped down the G20 agenda. Still, the French are pressing for implementation of the agreed rules, and for prevention of risks in areas where financial regulation is still insufficient, including the shadow banking system and commodity markets. G20 leaders have patted themselves on the back for the progress achieved on financial sector reform, but recognized that more remains to be done, calling on the Financial Stability Board (FSB) to finalize its work on systemically important financial institutions and on regulation and oversight of the shadow banking system. The FSB final recommendations on these issues are due for review during the next ministerial in October, so that concrete proposals can be discussed at the Cannes summit.

There are good reasons for the delays in the FSB work program. The work on SIFIs includes tricky decisions, such as how many institutions will be classified as global SIFIs, and how much extra capital they will have to hold. The IMF has been asked to help, and will contribute to a macroeconomic impact study of FSB recommendations.

Focus on the BICS

While the recent G20 meetings have unveiled important divergences among the BICs, they also highlighted common short-term challenges. As other emerging countries, Brazil, India, and China are dealing with overheating economies, plagued by rising inflation, booming property prices, and a surge of capital inflows. In distinct ways, reflecting their different exchange rate system, all three countries are facing a monetary policy dilemma, since higher interest rates to control inflation attract more capital, making it harder to prevent currency appreciation.

In **Brazil**, this dilemma has been particularly challenging. The policy mix of loose fiscal policy and tight monetary policy has produced the highest interest rates in the G20. Not surprisingly, Brazil has been flooded with hot money and is facing a drastic appreciation of the real (about 40 percent in the last two years) and a worrisome loss of industrial competitiveness. To defend the real, the authorities have resorted to various types of capital controls. But given current interest rate differentials, the real continues to be the carry trade currency of choice for speculators. The new government has also taken measures to cool down the economy, such as trimming the budget and raising taxes on consumer credit, while the central bank has lifted its benchmark rate multiple times, to 12%.[4] Still, inflation is running above 6%, and has recently breached the top end of the central bank target band (2.5-6.5%).

In **China**, while a new five-year plan marked a change in strategy from export-led growth to increased consumption, the more immediate challenge is to tackle inflation. The annual growth target for 2011 was already lowered a notch to 7% in an effort to avoid a hard landing. However, despite successive hikes in interest rates and required reserves, the central bank has had little success in taming inflation; year-on-year inflation was 5.3% in April, the highest rate since mid-2008. With

[4] This compares to a policy rate of 6.31% in China, 7.25% in India, 0.25% in the US, and 1.25% in the Eurozone.

inflationary pressures rising (especially regarding food prices), the internal debate underway in Beijing may turn in favor of a Yuan revaluation. On the other hand, the gradual process of rebalancing growth from investment to consumption was launched with the adoption of the 12th five-year plan in early March. The pro-consumption policies in the new plan are based on a more labor-intensive services model, higher wages (especially for rural workers), and the establishment of a social safety net to reduce precautionary savings. Wage-driven inflation would help reduce China's trade surplus and contribute to curb global imbalances. But it is too early to tell whether the surprise trade deficit in the first quarter of 2011 means progress in this direction, especially with international reserves breaking the $3 trillion mark at the same time. Indeed, the April data (a surplus) suggests caution in interpreting the numbers.

India is already contributing to global rebalancing by running a current account deficit. India's recent success story—deft management during the crisis and impressive growth performance —has been hailed as an example to be followed. But a series of corruption scandals has crippled the political process, debilitating long-term prospects. In the short term, inflation (particularly food-price inflation) is the key concern. India has the highest inflation rate among Asian economies—8.7 % in April —so the central bank has been raising interest rates aggressively to fight inflationary expectations and avoid social unrest. Unlike other emerging economies, India has refrained from imposing new capital controls or intervening heavily in the foreign exchange market to avoid rupee appreciation.

BIC's position on the key topics

While Brazil, India, and China regularly try to coordinate their positions with the other BRICS countries ahead of G20 meetings, the establishment of a common front on all issues is limited by a lack of collective interests. The mid-April BRICS summit in the Chinese resort of Sanya (with South Africa taking part for the first time) was the latest attempt to improve coordination, with a view to enhancing the group's influence at the global table. The timing of the meeting, coinciding with the G20 ministerial in Washington, encouraged speculation about the prospects for the G20.

Within the BICs—clearly the heavyweights in the club—there is a shared vision about their growing importance in global affairs, coupled with a desire to challenge US dominance. Beyond that, there are no automatic alliances between the three countries, but pragmatic positions on each issue, based on national interest. Importantly, the three countries are as much competitors as they are partners. Both Brazil and India are seeking a more balanced trade with China, as they see their manufacturing sector get wiped out by cheap Chinese imports, while their dependency on commodity exports keeps growing. So it is not surprising that they sometimes join the US-led chorus for Yuan revaluation.

On IMS reform

The BICs strongly support France's top priority of reforming the international monetary system. In particular, they have backed the efforts to promote alternative reserve currencies to reduce dependence on the dollar, including a greater role for the SDR. During the Nanjing seminar, France proposed including the Yuan in the SDR basket, in an effort to encourage China to adopt a more flexible exchange rate. While there was no objection from G20 countries to increasing the Yuan's role in global finance, no move is expected in the short term, since the Yuan is not fully convertible, or widely traded. But China is clearly interested, and has already taken steps to increase international settlements in Yuan, starting with intra-BRICS trade, as agreed in Sanya. At the same time, it did not take the French bait and refused to discuss exchange rate policy during the seminar—but still it had to listen to the usual American criticism of the undervalued Yuan.

Regarding global governance, the BICs continue to fight to enhance the voice of emerging countries in international organizations to better reflect changes in the geopolitical landscape. This issue will become more pertinent when the leadership

positions at the IMF and the World Bank are due for replacement—which is likely to be soon in the case of the Fund, after the Strauss-Kahn fallout. The BICs and other emerging countries have taken the opportunity to reiterate their view that the choice of leadership for these institutions should be based on merit, putting an end to the long-standing, unwritten rule guaranteeing a seat to a European national at the IMF and an American at the World Bank.

On global imbalances

China continues to resist US pressure for Yuan appreciation, counterattacking with heavy criticism of the FED's monetary easing. It has strong backing from Brazil. For the two countries, the origin of current financial imbalances is the excess liquidity created by ultra loose monetary policy in the US and other advanced countries. By contrast, India has been supportive of the FED's policy, on the grounds that boosting US growth is in everyone's interest—or perhaps in retribution for coveted US support for India's bid for a seat at the United Nations Security Council. Recently, criticism of US monetary policy has been damped by the FED's indication that Q3 is not in the offing.

In the currency wars, Brazil has battled both the US and China (mostly with kid's gloves in the latter case). It has accused both countries of keeping their currencies artificially depressed, forcing countries with flexible rates to take defensive measures to curb speculative inflows. Facing growing competition from its largest trade partner, Brazil has hardened its stance on China somewhat under the new government, seeking reciprocity for Brazilian manufactured exports and less dependency on commodity exports. With the *real* counted as the most appreciated of the 58 currencies ranked by the Bank of International Settlements, domestic concerns about de-industrialization have taken center stage.

The BICs flexed their muscle in the recent agreement on indicators, scoring important points. They objected to the French proposal to include the current account and international reserves in the list of indicators, and resisted the establishment of mandatory limits, suggesting that the G20 should only make 'recommendations' to countries to reduce global imbalances. Their objection to international reserves reflected concern that this could lead to the establishment of reserve adequacy norms, in line with the interest of advanced countries. Brazil's position on this issue seems to rest on ideological grounds, since the level of its reserves (3% of global reserves) is not considered excessive, especially if compared to China's stock (31% of the total).

China also managed to block the inclusion of the exchange rate in the list of indicators, accepting a reference to countries' exchange rate policy as a compromise. Brazil's position on the exchange rate is somewhat inconsistent, alternating support for its largest trade partner with criticism of the undervalued Yuan. A recent example of this 'tough love' is Brazil's proposal to include a debate on the impact of currency misalignments on international trade in the work program of the WTO.[5]

China perceives the whole global imbalances exercise as a US-led attempt to pressure for Yuan revaluation. The *indicative guidelines* validate this fear, since China (as well as the US) is certain to exceed the criteria for additional scrutiny (more than 5% of G20 output).

On managing capital controls

The debate on capital controls has been passionate, reflecting the range of views of G20 countries on the topic. Capital originators have tended to stress the 'pull factors' for the inflows—the improved fundamentals and growth prospects in emerging markets. Capital recipients (including the BICs) highlight the lax monetary policy in advanced economies and the risks that the inflows pose to emerging countries (including risk of reversal).

[5] See: Submission by Brazil to the Working Group on Trade, Debt and Finance, titled: "The relationship between exchange rates and international trade" (April 13, 2011).

The BICs are against global approaches to capital controls, arguing that it is up to individual countries to decide how to manage excessive inflows. Therefore, they strongly opposed the proposed IMF framework for capital controls. Although the new IMF stance is more pragmatic, recognizing the policy tools increasingly used by its membership as valid lines of defense, the proposal was perceived as yet another attempt by advanced countries to infringe on developing countries' sovereignty. Moreover, it had paid insufficient attention to 'push factors', since capital originators had not been prescribed any 'code of conduct'.

This ideological approach to the debate was championed by Brazil. Brazilian officials ratcheted up the rhetoric on capital controls, arguing strongly against the straightjacket of rules and calling for maximum flexibility to deal with capital inflows.

On the volatility of commodity prices

France's proposal to strengthen regulation in commodity markets was not supported by the BICs. Brazil, in particular, was firmly against market regulation, arguing that the best way to limit volatility of commodity prices is to encourage production and trade using market mechanisms, not through state intervention. France insisted that its objective was to control speculation (and its impact on prices), not to hurt exporters. As large agricultural exporters, Brazil and the US were on the same side of the debate, against market regulation.

The BICs tend to blame the expansionary monetary policy in the US and other advanced countries for rising global inflation, including through speculation in commodity derivatives. Therefore, they support stronger regulation of the derivatives market for commodities to prevent abuse and destabilizing activities, and thus alleviate the social impact of high and volatile commodity prices.

Regarding French's initiative on transparency, China was not in favor of establishing a common data base. Contrary to Brazil, where this information is public, information on food stocks is considered as an item of national security in China.

What next?

The recent G20 meetings have firmed up the group's reputation as long on talk but short on results. Each meeting seems to introduce a fresh round of finger-pointing, with US monetary policy and China's exchange rate policy as the favorite targets. In the absence of another crisis, progress in the G20 agenda is likely to be incremental at best. Expect more process in Cannes, not firm agreements.

Against this background, criticism of the G20 is likely to continue. Skeptics will note that the lack of cohesiveness and common interests in the group will prevent meaningful global economic coordination. They will conclude that, in such a large, consensus-based forum, the odds are high that group leaders will remain deadlocked on the key issues. Optimists will assess the G20 experience in a more favorable light, stressing the role of active debate in a multilateral forum of key policy topics previously discussed only at the national level. Their hope is that common sense will eventually prevail and—bit by bit—global economic coordination will yield some tangible results.

One thing is clear: the BICs have boosted their influence along the way, and are likely to keep their seat at the global table. However, their international influence will depend on how they handle their domestic economic challenges, including the possibility of a bust following the recent booms. In any event, the future group dynamics is likely to hinge on the pivotal role of China in the global stage, which will shape its relationship with Brazil and India as partners or competitors.

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